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SUBJECT: RELIABLE COMMERCIAL DISPUTE RESOLUTION: AN ABSENT  
PREREQUISITE FOR FDI INTO RUSSIA

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Summary  
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11. (SBU) An unpredictable legal system, specifically as it relates to resolving business disputes, has undermined foreign (and domestic) investor confidence in Russia. Some investors have focused on international arbitration and private dispute resolution to resolve commercial disputes involving Russia. The failure of Russian courts, however, to enforce arbitral awards has proven to be an obstacle. Persuading Russia to improve its adherence to international norms, including standards for enforcing judgments in Russia, would make its investment climate more attractive. While the recent Embassy sponsored conference on commercial dispute resolution stimulates debate on the progress achieved (septel), changing Russia's current nationalistic approach to arbitration enforcement does not appear imminent. End summary.

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Importance of Reliable Business Dispute Resolution  
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12. (SBU) Business dispute resolution can take a number of forms: litigation, arbitration, and mediation, but none is credible if the judgment or award cannot be enforced. Russia's infamously corrupt court system has led some legal practitioners to place their hopes on resolving commercial disputes via arbitration. Such arbitration could take place in international fora, such as Sweden or New York, or in Moscow. The International Commercial Arbitration Court (MKAS) in Moscow is the leading venue for arbitrating in Russia.

13. (SBU) Some lawyers argue that international fora are preferable to MKAS because those arbitrators have more experience. That said, MKAS is gaining greater experience and sophistication in arbitrating. The challenge, however, is shifting from getting a decision on the merits to getting the award enforced in Russia. As Mark Appel (please protect), Senior Vice President of the International Center for Dispute Resolution, told us, only about 50 percent of awards (this included those rendered by both international

and Russian arbitration courts) actually were enforced. He noted a strong correlation between the perceived strength of the "losing" side's Kremlin connections and the difficulty of getting an award enforced.

¶4. (SBU) While optimists take heart that more cases are being filed and more awards are being enforced in Russia, pessimists counter that the global economic crisis has engendered more disputes and the awards being enforced are paltry. (Septel.) What does seem clear though, is that enforcement is easier if the "losing" side has assets outside of Russia that can be attached. For example, Franz Sedelmeier was awarded USD 2.3 million, plus interest, in relation to a 1995 property dispute with the GOR in St. Petersburg. He was able to attach GOR-owned property in Berlin, but, almost 15 years on, he is still trying to get full relief.

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Poor Enforcement Increases "Russia Discount"  
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¶5. (SBU) For business, tales like Sedelmeier's -- as well as those related to the Yukos, Bank of New York, and Hermitage cases -- are relevant. As one British oil and gas lawyer told us, once the parties have resorted to an outside party to resolve a dispute, the business relationship is ruptured and it is a matter of settling accounts. According to him, the value in impartial resolution is the discipline it brings to the parties' behavior in avoiding a dispute. For this reason, he concluded, the very public (and recent) disputes of Telenor/Vimpelcom and TNK-BP further decrease the value of potential deals in Russia vis-a-vis other emerging markets.

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Some See Fewer Deals  
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¶6. (SBU) An American oil and gas partner at a major international law firm told us that he had seen a definite waning of interest among the oil and gas sector multinationals over the past year. While he was unwilling to conclude that this was entirely attributable to rule of law issues -- the Strategic Sectors Law has also had an effect -- he noted that TNK-BP and Sakhalin GOR-supported takeovers had definitely had a chilling affect on investor interest. He also claimed that Russian companies, such as Lukoil, were not inaugurating new Russian onshore business.

¶7. (SBU) Boris Karabelnikov, Professor and Arbitrator at MKAS, told us that the only investors coming to Russia were those who "had to be here." In Karabelnikov's opinion, FMCG's (fast-moving consumer goods enterprises), such as Proctor and Gamble, Coca-Cola, and Pepsi-Cola, could not afford to ignore the advantages that FDI provided to access Russia's consumer market. He concluded that not a single large foreign investment in recent years had been undertaken without Kremlin protection.

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Comment  
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¶8. (SBU) Poor dispute resolution is a significant factor in investors' decisions about Russia, although its precise effects are not always quantifiable. Nonetheless, as Russia seeks to increase foreign investment, we will continue to encourage Russia to improve its dispute resolution system to improve its investment climate.

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